

October 31st, 2017

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
baselcommittee@bis.org

Re: Implications of Fintech Developments for Banks and Bank Supervisors

Ladies and Gentlemen:

The American Bankers Association (ABA)¹ welcomes the opportunity to comment on the consultative document issued by the Basel Committee on Banking Supervision (BCBS) in August 2017: *Sound Practices: Implications of fintech developments for banks and bank supervisors* (the **Consultative Document**).

ABA believes that innovation in financial services continues to have tremendous potential to benefit customers as it has throughout the history of banking. Innovation can give customers improved transparency into the financial products they use every day, make it possible to extend credit to many more borrowers, and promote financial inclusion, giving greater access to financial services. However, these benefits are only realized when innovations are delivered responsibly. This means getting regulation right is critical. Regulation must be flexible enough to allow banks to innovate while ensuring that customers receive the protection they have come to expect from their banks wherever they get their financial services.

The Consultative Document provides a concise, high-level summary of both the current landscape of technical innovation within the financial services sector, and many of the key important challenges to the business models of banking institutions and non-bank technology companies. The Consultative Document's observations will be useful to banking industry participants, national supervisors and other parties interested in the policy implications of the rapid technological changes affecting financial services. It also underscores the important role that innovation and technological change have always played and continue to play in successful banking.

The ABA would like to thank the BCBS for hosting an industry outreach event in New York City on October 17, 2017. The discussion was informative and ideas were actively shared by all of the participants. The key takeaway from the meeting was that banking agencies around the world are responsible for the oversight of banks and do not have the authority to provide direct oversight to the non-bank fintech providers. Any international framework would do little to bring non-bank fintech providers under consistent regulation. The meeting also highlighted how banks

¹ The American Bankers Association is the voice of the nation's \$17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$12 trillion in deposits and extend more than \$9 trillion in loans.

are benefitting from leveraging new technologies and while there was general consensus that all entities providing bank-like services should be subject to the same level of oversight, it is also important not to smother innovation that could benefit consumers, banks and economies globally.

ABA wishes to highlight four fundamental points that must inform these policy discussions:

- Innovation, technological change and related risks are fundamental to banking and are well captured in existing regulatory frameworks.
- While innovation within the banking industry is well captured by regulators today, nonbank actors are inconsistently captured.
- Financial technology continues to evolve quickly and its breadth and impact on jurisdictions is vast and varied, thus it is not well suited to international frameworks.
- There are areas that benefit from international coordination, and robust coordination in those areas already exists.

Innovation, technological change and related risks are fundamental to banking and are well captured in existing regulatory frameworks.

Technology plays a key role powering innovation in banking. Banks have always leveraged new technologies to deliver banking products in more effective ways, and that process continues today. The ultimate objective of innovation is meeting constantly evolving customer needs for financial services. Banks, in order to be successful, have always faced, and met, this challenge.

While today's technologies are powering innovations that stand to deliver tremendous value to customers, they do little to fundamentally change the business of banking. Most fintech activities leverage technology to deliver, what is at its core, a fundamental banking service like lending or making a payment. The term "fintech" – often used to describe the convergence of technology and financial services – is now the moniker used for technology-focused start-up companies, but new methods of customer interaction, data analysis, transaction processing and other traditional banking functions must not obscure the underlying reality that this process is inherent in banking. Many of these activities are already captured by existing regulation. Appropriately, most regulators around the world have focused on regulating the banking activity being offered, not the technology that is being used to deliver it.

As noted in the Consultative Document, technological change may not only result in new risks, but also can open up new opportunities for banks and their customers.² Regulators should be focused on supporting this innovation while managing any new risks.

Collaboration among regulators will be essential to an effective regulatory framework, which both supports these opportunities and fosters management of the related risks that will be enhanced. If done correctly, it will serve to spread knowledge quickly, minimize inconsistencies, avoid conflicting guidance, and ultimately speed adoption of valuable innovations. As an

² See Consultative Document, Observation 1.

example, one promising mechanism could be pilot programs, which can be important elements in technology deployment in a safe and sound manner. Pilot programs seem a natural area in which collaboration among regulators, at least for exchange of knowledge and information, will be important and speed adoption of beneficial technological innovation more broadly.

Banks and national supervisors are focused on both opportunities and risks of technological evolution. The Consultative Document notes risks on which banks and their national supervisors should focus as they implement technological changes. Among others are:

- Strategic, operational, cyber and compliance risk (**Observations 2 and 3**)
- Risks inherent in the use of third parties to outsource operations in pursuit of cost reductions, operational flexibility and other business objectives (**Observation 4**)

In many markets and national regulatory regimes, there are well-developed, detailed measures in place and active in response to these risks. For example, in the United States, the Federal Office of the Comptroller of the Currency (**OCC**), which regulates nationally chartered banks, has put in place standards for regulating information technology risk,³ and other US regulators have adopted similar guidance. Similarly, the OCC established standards for risk governance, including operational and compliance risk, for large, complex banking institutions.⁴ US regulators have also addressed specific concerns related to third-party service providers in such publications as the Information Technology Examination Handbook, published by the US Federal Financial Institutions Examination Council (**FFIEC**), an umbrella group coordinating supervisory policies among US banking regulators.

Though these and other standards must continually evolve based on experience and input from the banking industry and the public, they make clear that national authorities and banking institutions are well aware of, and acting to, address the sorts of risks described in the Consultative Document.

While innovation within the banking industry is well captured by regulators today, nonbank actors are inconsistently captured.

One thing technology *has* fundamentally changed is the ability of technology driven companies to quickly reach customers and directly offer financial services. Today, a company does not need a branch network to reach a mass market. In many cases, this has allowed non-banks to develop direct customer relationships. While innovation at banks is closely watched by regulators, non-banks offering these services are not consistently captured.

National regulators today are focused on bank entities and rarely have jurisdiction to supervise and regulate the fintech players for whom this consultation document highlights. Therefore, an international framework that does not include oversight of fintechs will not address the evolving risks that have been identified requiring supervision. Jurisdictions should amend laws to ensure

³ Title 12, Code of Federal Regulations, Part 30, Appendix B. The U.S. Code of Federal Regulations is cited throughout as “CFR.”

⁴ 12 CFR, Part 30, Appendix D.

that banking regulators are able to monitor these companies to ensure that they are regulated consistently. This will ensure that customers are equally protected wherever they receive their financial services.

Financial technology continues to evolve quickly and its breadth and impact on jurisdictions is vast and varied, thus it is not well suited to international frameworks.

The financial technology market continues to evolve quickly and is developing differently across the world. Regulators around the world are carefully monitoring its development and taking action where necessary.

Due to the rapid pace of innovation, local regulators need flexibility to monitor developments in their market and respond quickly when needed. Premature regulation may impede innovation and risks failing to accurately capture appropriate activities as the market evolves. At the same time, technology has allowed financial service firms to quickly reach customers with new products. When abuses arise, regulators must move quickly to address them. Usually this means evaluating how a technology company's activities fit into existing banking regulatory frameworks. An international framework could limit local regulators' ability to quickly respond and tailor regulation as the market evolves.

The business models being developed and the risks associated with them are quite different in each country and the regulation needed in one market might not be appropriate for another. As such an international regulatory framework for fintech is not appropriate at this time. Marketplace lending, for example, looks very different in the U.K., where it is often peer-to-peer, than it does in the U.S., where institutional investors make up much of the funding. A one-size-fits-all approach to regulation would inevitably fail to address key risks in some areas and restrict innovation in others. This is why local regulators need the flexibility to tailor regulations to address the risks that develop in their markets.

There are key areas where international coordination is needed and in many cases is already underway.

Though most of the implications of technological innovation in financial services are best addressed through dialogue in national markets among banking institutions, their national regulators and the public, ABA notes three areas in which cooperation across multiple geographic markets can be particularly important: maintenance and enhancement of cybersecurity, combating money laundering and terrorism financing, and maintaining the strength and security of the international payments system. Existing regimes provide robust responses to address these risks.

In promoting cybersecurity, government authorities and private-sector financial institutions have participated since 1999 in the Financial Services Information Sharing and Analysis Center (**FS-ISAC**). Initially focused on sharing information among US-centered governmental units and financial services firms, FS-ISAC from 2013 has grown to over 7,000 members in 37 other countries, actively working with government entities in those countries, as well as regional computer emergency readiness teams and industry associations. The FS-ISAC regime provides a

significantly enhanced degree of coordination between public- and private-sector entities both to permit responses to specific threats and to share information acquired in the process that can support continuing enhancements in cybersecurity and resiliency.

In combatting money laundering and terrorist financing, the Financial Action Task Force (FATF) is an inter-governmental body established in 1989 that now includes 35 member jurisdictions. The FATF sets standards and promotes effective implementation of legal, regulatory and operational measures for combating money laundering and terrorist financing within the international financial system. The FATF's recommendations and standards promote a coordinated response to these threats to the integrity of the financial system and the sharing of concepts and operational insights among members. The FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter-measures, and promotes the adoption and implementation of appropriate measures globally. It also collaborates and shares information with other international stakeholders.

The U.S., Canada and numerous other jurisdictions have identified improving the speed, safety, and efficiency of cross-border payments as a priority. While each country or jurisdiction should be free to develop the best domestic payment system they can, it is important that international payments also be considered. With these cross-border payments comes required coordinated oversight from the regulators of each jurisdiction. As these payments approach real-time in speed of clearance and settlement, coordinated regulatory approaches become more important.⁵

ABA believes that these examples conclusively demonstrate that, in the three areas of cybersecurity, money laundering/terrorist financing and payments system protection, international coordination and cooperation is healthy and proceeding effectively through existing channels and cooperative efforts.

Conclusion

Innovation in banking promises to deliver significant benefits to banks, global economies, and most importantly banking customers worldwide. It is critical that we get regulation right so that we can fully realize these benefits. At this time, we support each jurisdiction's own bank supervisory agencies in their efforts to address the challenges and opportunities related to financial technologies. Bank supervisors have the authority to supervise banks and well capture any risks through that regulation today. Developing an international fintech regulatory framework at this time would risk inhibiting innovation by limiting national regulators' flexibility and would fail to address any developing risks because most bank supervisors don't have the authority to provide oversight of nonbank companies.

⁵ See *Federal Reserve: Next Steps in the Payments Improvement Journey*, at <https://www.federalreserve.gov/newsevents/pressreleases/files/other20170906a1.pdf> (September 6, 2017), noting a number of standards-setting committees and similar organizations active in payments system policy matters in which the Federal Reserve participates.

We hope you find our comments on the Consultative Document useful. Please let us know if you have any further questions or would like to discuss our recommendations in further detail.

Sincerely,

Rob Morgan
Vice President, Emerging Technologies